



Investment Office

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

(916) 795-3400

October 20, 2008

AGENDA ITEM 3

TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE

I. SUBJECT: Policy on Divestment

II. PROGRAM: Total Fund

III. RECOMMENDATION: Adopt Divestment Policy Proposal #1 which requires CalPERS to divest or underweight an investment if continued ownership is not prudent.

Adopt Constructive Engagement Proposal #1 creating a statement that the Investment Committee favors constructive engagement.

Upon adoption of this recommendation, staff would return to the Policy Subcommittee with actual policy language.

IV. ANALYSIS:

At the May 2008 Investment Committee meeting, it was requested that staff bring forward a proposed policy on divestment. This item sets forth three conceptual ways to approach the divestment issue and two conceptual ways to approach related constructive engagement issues. Upon direction, staff will return to the Subcommittee with specific policy language.

BACKGROUND

Divestment is an issue that has come up repeatedly over the course of CalPERS' existence. Divestment issues arise not only from legislation, but also from requests by constituent or external groups, as well as internally.

CalPERS has a strong record of entering into constructive engagement with companies. This process creates dialogue with companies and encourages reform consistent with the long term value and sustainability of our investments. As a general rule, CalPERS has favored engagement over divestment, based on various factors including the fact that upon divestment, we lose our ability to effectuate change through the constructive engagement process. The basis for CalPERS positions in engaging companies in its portfolio is found in the Global Principles of Accountable Corporate Governance, which in turn embrace various other overarching documents including the Global Sullivan Principles, the UN Global Compact, and the Ceres 14-point Climate Change Governance Checklist. Other guiding documents include the United Nations Principles for Responsible Investment (UN PRI), to which CalPERS was one of the original signators, and the Emerging Equity Markets Principles that set forth standards for investing in emerging markets.

ACTIONS TAKEN

In order to better understand the evolution of divestment issues as they pertain to institutional investors and particularly public pension funds, PCA has written a Divestment Research Report ("Report")(Attachment 1), which outlines the past and present divestment related issues that CalPERS has dealt with over the years. The Report also examines other pension funds' policies and procedures relating to the issue of divestment.

In addition to the Report, PCA has written a memorandum that outlines three options/approaches for a divestment policy (Attachment 2). In developing the options, Investment Office staff, the Legal Office, Wilshire Associates, as well as external fiduciary counsel, worked with and provided input to PCA. An attorney-client privileged memorandum from fiduciary counsel is being provided to Policy Subcommittee members under separate cover. In addition to the options for a divestment policy, PCA proposes two options for a policy statement that would address CalPERS' approach to engagement in the context of divestment issues.

RECOMMENDATION

It is staff's recommendation that the Subcommittee adopt Divestment Policy Proposal #1, which requires CalPERS to divest or underweight an investment to the extent they conclude that continued ownership of the investment is no longer prudent, or, in the case of a new investment, would be imprudent. Also, staff recommends Engagement Policy Proposal #1 which would create a statement that the Investment Committee favors constructive engagement. Both of these policies reflect the ongoing effort by CalPERS to engage companies and encourage change while maintaining a strong commitment to our fiduciary duty to members and the fund.

Based on input and direction from the Subcommittee, staff will work with PCA to prepare proposed policy language for submission to the Policy Subcommittee.

V. STRATEGIC PLAN:

This item is not a product of the CalPERS Strategic Plan.

VI. RESULTS/COSTS:

Costs for development of this item have included the engagement with PCA for the attached Report and memorandum, obtaining advice from fiduciary counsel, and associated staff time. It is our hope that the resulting policy will provide transparency and a clear framework for addressing divestment issues.

Anne Stausboll
Interim Chief Investment Officer